

**IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF KANSAS**

LONE STAR STEAKHOUSE AND)
SALOON, INC. AND LONE STAR)
STEAKHOUSE AND SALOON OF)
MICHIGAN, INC.,)

Plaintiffs,)

VS.)

CASE NO. 02-1185-WEB

LIBERTY MUTUAL INSURANCE)
GROUP AND LIBERTY MUTUAL)
FIRE INSURANCE COMPANY,)

Defendants.)

MEMORANDUM AND ORDER

Before the court is plaintiffs' Motion for Leave to File First Amended Complaint. (Doc. 19). Defendants responded and oppose the motion (Doc. 20), and plaintiffs have filed a reply brief (Doc. 23).¹

FACTUAL BACKGROUND

Lone Star operates a restaurant in Battle Creek, Michigan. As a part of the

¹ While there are two named plaintiffs and two named defendants, for purposes of this motion plaintiffs will be referred to collectively as "Lone Star" and defendants as "Liberty Mutual."

construction of the restaurant, Lone Star maintained a water storage basin on its property to handle storm water run off from the restaurant property. Battle Creek Hospitality, Inc. operated a Holiday Inn Express on the property next to Lone Star's restaurant.

In 1998, Battle Creek filed suit against Lone Star alleging that overflow from the water basin damaged its property ("1998 case"). Liberty Mutual defended Lone Star in the initial action. The 1998 case was settled for \$95,000 and Liberty Mutual paid the full amount of the settlement.

On January 21, 2000, shortly after the settlement of the 1998 case, Battle Creek filed a second action ("2000 case") against Lone Star alleging nuisance and trespass for additional flooding incidents, seeking damages in excess of \$6,000,000. Once again, Liberty Mutual defended Lone Star.² Liberty Mutual sent reservation of rights letters to Lone Star indicating that there were questions about coverage under their insurance policy.³

² There is a factual dispute between the parties as to who actually retained the attorneys to defend the 2000 case and who directed their work on that case. It is apparently undisputed that Liberty Mutual paid any billings by the law firm for defense of the 2000 case.

³ Liberty Mutual sent two reservation of rights letters, the first on April 23, 2001, and the second on March 25, 2002. The parties have provided copies of those letters for the court's review. The April 23, 2001 letter stated that an exclusion for "expected or intended injury" might apply to preclude coverage. The March 25, 2002

Shortly before a settlement conference set in the 2000 case, Liberty Mutual advised Lone Star that it was only willing to contribute a maximum of 20% of any settlement amount up to \$750,000 (*i.e.*, a maximum of \$150,000). The settlement conference proceeded on May 7, 2002, but no settlement was reached. Lone Star later settled the 2000 case with Battle Creek for \$890,000.

On May 30, 2002, Lone Star filed this action alleging in Count I that Liberty Mutual's failure to contribute to the settlement of the 2000 case resulted in a breach of their contract of Commercial General Liability Insurance. Lone Star also claims in Count II that by wrongfully denying their claim, Liberty Mutual is liable for a "bad faith" breach of its duty of good faith and fair dealing and is further liable for punitive damages.

DISCUSSION

Plaintiffs now seek an order granting them leave to amend their complaint to add a new Count III. That proposed claim alleges that Liberty Mutual, by failing to timely assert a defense to coverage in a reasonable manner, is liable to plaintiffs for the amount of the settlement they paid to Battle Creek because Liberty Mutual is "estopped to raise the defense of noncoverage [under the

letter referred to this same exclusion, but also stated that the definition of an "occurrence" may not have been met in this case.

insurance policy], or has waived such right. . . .” (Doc. 19, Attached First Amended Complaint, ¶ 35).

Defendants object to the proposed amendment as untimely, prejudicial, and futile. Defendants claim that allowing amendment of a futile claim at this late stage would prejudice defendants by requiring them to defend against a factually and legally baseless claim, and to reevaluate and potentially amend disclosures and witnesses. (Doc. 20 at 2).

Rule 15(a) provides, in pertinent part, that “a party may amend the party’s pleadings only by leave of court or by written consent of the adverse party; and leave shall be freely given when justice so requires.” Fed.R.Civ.P. 15(a). In the absence of any apparent or declared reason, such as undue delay, undue prejudice to the opposing party, bad faith or dilatory motive, failure to cure deficiencies by amendments previously allowed, or futility of amendment, leave to amend should, as the rules require, be freely given. *Foman v. Davis*, 371 U.S. 178, 182, 83 S.Ct. 227, 230, 9 L.Ed.2d 222 (1962); *Frank v. U.S. West, Inc.*, 3 F.3d 1357, 1365 (10th Cir. 1993). (Emphasis added). Leave to file an amendment to a pleading is within the sound discretion of the court. *LeaseAmericia Corp. v. Eckel*, 710 F.2d 1470, 1473 (10th Cir. 1983).

When a party seeks leave to amend after the deadline established in a

pretrial scheduling order, however, that party must satisfy the standards set forth in Fed.R.Civ.P. 16(b), as well as Fed.R.Civ.P. 15(a). See ***Deghand v. WalMart Stores, Inc.***, 904 F.Supp. 1218, 1221 (D.Kan. 1995). Rule 16(b) provides that “a schedule shall not be modified except upon a showing of good cause and by leave of the district judge or, when authorized by local rule, by a magistrate judge.”

In ***Deghand***, the court discussed the good cause requirement:

The ‘good cause’ standard primarily considers the diligence of the party seeking the amendment. ***Tschantz***, 160 F.R.D. at 571 (citations omitted). The party seeking an extension must show that despite due diligence it could not have reasonably met the scheduled deadlines. ***Pfeiffer v. Eagle Mfg. Co.***, 137 F.R.D. 352, 355 (D.Kan. 1991); Fed.R.Civ.P. 16 advisory committee note to 1983 Amendment. “[C]arelessness is not compatible with a finding of diligence and offers no reason for a grant of relief.” ***Johnson***, 975 F.2d at 609 (citations omitted). The lack of prejudice to the nonmovant does not show “good cause.” (Citations omitted). The party seeking an extension is normally expected to show good faith on its part and some reasonable basis for not meeting the deadlines. ***Putnam v. Morris***, 833 F.2d 903, 905 (10th Cir. 1987).

904 F.Supp. 1218, 1220 (D.Kan. 1995).

It is undisputed that plaintiff’s motion to amend was not filed by the October 1, 2002 deadline set out in the August 16, 2002 Scheduling Order (Doc.

14 at ¶ IIIa).⁴ Plaintiff, however, argues that defendants will not be prejudiced if plaintiff is allowed to add a claim of estoppel and waiver at this early stage of the proceedings. The court agrees that defendants' claim of prejudice is not persuasive. Plaintiff's new claim of estoppel and waiver appears to involve the same facts and the same witnesses that are relevant to the issues raised in Counts I and II of the initial Complaint. In addition, because the parties have had difficulties concerning production of documents, very little discovery has actually been conducted in this case. As a result, the court recently entered a Second Revised Scheduling Order (Doc.33) which extended virtually all discovery deadlines. Defendants have not shown that they would be prejudiced as a result of the timing of the motion to amend. Lack of prejudice to the nonmoving party, however, does not constitute the "good cause" required under Rule 16(b) and *Deghand* to justify filing a motion to amend after the deadlines set in a scheduling order.

It appears that plaintiffs knew, or should have known, all the relevant information necessary to decide whether or not to assert any estoppel and waiver claim at the time this suit was initially filed on May 30, 2002. By that time,

⁴ A Revised Scheduling Order was entered on November 4, 2002 (Doc. 16), but it only revised the dates for filing expert reports.

defendants had already issued both of its reservation of rights letters. Defendants also point out that during settlement negotiations in the underlying action on or about May 7, 2002, defendants again advised plaintiffs of their coverage position. The Tenth Circuit has upheld the denial of a motion to amend where the party seeking amendment knows or should have known of the facts upon which the proposed amendment is based, but fails to include them in the original complaint. *Frank v. U.S. West, Inc.*, 3 F.3d 1357, 1365 (10th Cir. 1993), quoting *Las Vegas Ice & Cold Storage Co. v. Far West Bank*, 893 F.2d 1182, 1185 (10th Cir.1990).

Because the court finds plaintiffs' motion to amend was untimely, it could deny the motion on this procedural ground alone. The court prefers, however, to address the merits of the motion rather than the procedural issue of timeliness. This requires to court to consider the issue of whether the proposed claim based on waiver and estoppel would be futile. A proposed claim is futile if it would be subject to a motion to dismiss. *See Potts v. The Boeing Co.*, 162 F.R.D. 651, 653 (D.Kan. 1995) (claim not futile unless it appears beyond doubt that plaintiff can prove no set of facts in support of his claim).

During oral arguments on the motion, the court questioned counsel about whether estoppel and waiver could support an affirmative claim for relief by an insured, or whether estoppel and waiver can only be asserted as defenses when an

insurer asserts a lack of policy coverage. Neither party was able to present the court with definitive authorities on this point.

Under Kansas law (which governs this diversity action),

waiver cannot be used to expand the coverage of an insurance contract; it applies only to forestall the forfeiture of a contract.

Hennes Erecting Co. v. National Union Fire Ins. Co., 813 F.2d 1074, 1078 (10th Cir. 1987). *See also Western Food Products Co. v. United States Fire Ins. Co.*, 10 Kan.App.2d 375, Syl. ¶ 3, 699 P.2d 579 (Kan.Ct.App. 1985) (waiver and estoppel); ***Unruh v. Prudential Prop. and Cas. Ins. Co.***, 43 F.Supp.2d 1237, 1239-40 (D.Kan. 1999) (estoppel). As one commentator notes:

Generally speaking, however, the rules of waiver and estoppel can not be used to expand coverage that is specifically and unambiguously excluded by the policy language. This position is strongly favored since to extend coverage through the use of the doctrine of waiver and estoppel will essentially rewrite the contract entered into by the parties. Thus, the doctrines should only be used to remove the insurer's ability to rely on certain exclusions, limitations or conditions, but not to add new insuring agreements to the policy.

9 *Holmes' Appleman on Insurance 2d*, § 57.5, p. 389 (footnote omitted). *See also* 7 *Couch on Insurance 3d*, § 101.8, pp. 101-20 to 101-24.

Commentators also note, however, that some modern cases support the

view, either expressly or by implication, that under certain circumstances an insurer can be equitably estopped from asserting certain policy provisions, even though the effect may be to find policy coverage for risks not covered by the policy or risks that have been expressly excluded from coverage. *See 7 Couch on Insurance* 3d, § 101.9, p. 101-28. A common example of the use of equitable estoppel principles in the insurance context involves situations where the insurer has commenced the defense of the insured under a liability policy without disclaiming liability and giving notice of reservation of rights where the insurer had sufficient knowledge that the claim was not covered under the specific terms of the policy. *See 7 Couch on Insurance* 3d, § 101.10, pp. 101-30 to 101-31. These situations are sometimes described as exceptions to the “general rule” that coverage cannot be expanded by use of waiver and estoppel.

Kansas law recognizes that:

when an insurer has undertaken a defense under a liability policy, a reservation of rights regarding defenses to coverage is ineffective "unless it makes specific reference to the policy defense being relied upon by the insurer." *North River*, 628 F.Supp. at 1134; *see also Bogle v. Conway*, 199 Kan. 707, 433 P.2d 407, 411-13 (Kan.1967); *Henry*, 381 P.2d at 544-45.

Sapp v. Greif, 141 F.3d 1185, 1998 WL 165116 at *5 (10th Cir.1998). Thus, it is important that:

the insured must be fairly and timely informed of the insurer's position. That information should include the basis for the position taken by the insurer. Only then is the insured in a position to make his choice as to the course to pursue in protecting himself. The insured may or may not wish to permit the insurer to carry on his defense under its contract obligation to do so.

Bogle v. Conway, 199 Kan. 707, 713, 433 P.2d 407, 412 (1967). See *Golf Course Superintendents Association of America v. Underwriters at Lloyd's, London*, 761 F.Supp. 1485, 1492-93 (D.Kan. 1991) (recognizing that under Kansas law an insurer may be estopped from denying coverage if insurer conducted the defense, failed to adequately notify insured of reservation of rights, and insurer could show prejudice).

Plaintiff urges that this case falls within the exceptions to the general rule, and argues that under the facts of this case defendant has waived, or is estopped to deny, coverage because it did not give timely notice of its reservation of rights to plaintiff while it continued to control the defense of the claim against plaintiff.⁵ Defendant, on the other hand, argues that the general rule is applicable and plaintiff is simply trying to expand (or manufacture) policy coverage by claiming

⁵ As previously noted, there is a factual dispute as to who was actually “controlling” the defense of the 2000 case. Under the reasoning in *Golf Course Superintendents*, control of the defense is a critical element in any showing of prejudice by an insured. 761 F.Supp. at 1493.

waiver and estoppel.

While the parties disagree strongly on the viability and applicability of the doctrines of waiver and estoppel in the insurance context, the court does not need to reach the merits of that issue in order to decide the present motion to amend. Instead, the critical question is whether waiver and estoppel can be the basis of an affirmative claim for relief as defined in Fed.R.Civ.P. 8(a), or whether they are only defenses or affirmative defenses as defined in Fed.R.Civ.P. 8(b) and (c). If waiver and estoppel can be the basis of an affirmative claim for relief, then the proposed amendment may not be futile. On the other hand, if waiver and estoppel can only be used as defenses, then plaintiffs' attempt to amend to include such an affirmative claim would be futile.

As previously noted, neither party has cited any case which clearly stands for the proposition that the theories of waiver and estoppel which plaintiff is seeking to add as Count III in its proposed Amended Complaint can support an affirmative claim for relief. On the other hand, Fed.R.Civ.P. 8(c) specifically includes both "estoppel" and "waiver" as affirmative defenses which must be set forth in a pleading to a preceding pleading. *But see, Golf Course Superintendents*, 761 F.Supp. at 1492 (where estoppel is called "a noncontractual basis for liability.").

After fully considering the briefs and arguments of the parties, the court concludes that waiver and estoppel can not be used to support an affirmative claim for relief. This is consistent with the general rule that waiver and estoppel cannot be used to expand coverage of the policy. If applicable at all, waiver and estoppel can only be used as defenses to an insurer's denial of policy coverage. Therefore, plaintiff's attempt to state an affirmative claim for relief based on waiver and estoppel would be futile and the motion for leave to amend should be denied.

The court cautions, however, that this procedural ruling in no way precludes or prevents plaintiff from raising and arguing the defenses of waiver or estoppel in this case in an attempt to bar defendant from denying coverage under its insurance policy.⁶ Similarly, nothing in this opinion should be interpreted as a finding or conclusion that the defenses of waiver or estoppel are, or are not, meritorious under the facts of this case. That issue can not be decided at this stage of the proceedings.

⁶ In this case, the applicability of waiver and estoppel only come into play after defendant denies that there is a covered claim under the insurance policy in their answer. Since defendants' answer did not contain a counterclaim, the federal rules do not allow any further pleadings as a matter of course (although the court "may" order a reply to an answer). *See* Fed.R.Civ.P. 7(a). Because plaintiffs were not required to file any further pleadings after they had received defendants' answer, there has been no occasion for plaintiff to affirmatively plead waiver or estoppel. Therefore, no argument can be made that plaintiff is procedurally barred from now raising waiver and estoppel as defenses.

IT IS THEREFORE ORDERED that plaintiffs' Motion for Leave to File First Amended Complaint (Doc. 19) is denied.

Copies of this order shall be mailed to counsel of record for the parties.

Dated at Wichita, Kansas, on this 13th day of March, 2003.

s/ Donald W. Bostwick
DONALD W. BOSTWICK
United States Magistrate Judge